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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 000368

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DEPARTMENT FOR EUR/CARC AND EB/ESC
DEPT OF ENERGY FOR FE - SWIFT AND OS - WILLIAMSON

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SUBJECT: STATUS OF THE KASHAGAN-BTC IGA -- THE VIEW FROM
AZERBAIJAN

REF: A. A. 05 BAKU 1960

1B. B. 05 BAKU 1823
1C. C. 05 BAKU 1059

Classified By: Ambassador Reno L. Harnish, III, reasons 1.4 (b), (d) and (e).

11. (C) SUMMARY. International energy companies in Baku believe Azerbaijan is holding out for better terms in the draft Inter-Governmental Agreement (IGA) with Kazakhstan over trans-Caspian oil transport. Parliament Deputy Speaker Valekh Alasgarov appears to be leading the charge for President Aliyev, arguing that the IGA and the associated Host Government Agreements (HGAs) need to be negotiated simultaneously and that Azerbaijan deserves more from the project. The IGA in its current form will not be approved by Azerbaijan's Parliament, says Alasgarov. The GOAJ appears willing to exploit Azerbaijan's role as a transit country to the project in order to get the IGA language it wants. Industry sources confirm that an IGA is necessary for a project of this scale to proceed. END SUMMARY.

COMPANIES: AZERBAIJAN WANTS A BETTER DEAL

12. (C) Sources in the international energy community in Baku believe that the reason an IGA has not yet been signed for the Kashagan-BTC project is because Azerbaijan wants better terms. Reportedly, President Aliyev feels that Azerbaijan deserves more because of its emerging role as a vital transit country. Additionally, there are supposedly still bitter feelings over what is seen as President Nazarbayev's last-minute decision not to sign the draft IGA during the BTC First Oil Ceremonies in May 2005. Finally, the recent changes in Azerbaijan's energy establishment (Ref A) have slowed Baku's energy decision-making process in general.

13. (C) The persistent failure to come to closure on the IGA is beginning to cause some concern among Baku-based international oil companies. The chairman of TOTAL, which has the lead on transportation issues for the north Caspian producers, met with President Aliyev on the margins of the

latter's recent meetings in Paris. In this meeting, which was conducted with a minimum of publicity, TOTAL urged that the IGA be concluded soon. Perceptively, both TOTAL and Chevron executives in Baku have characterized Azerbaijan as attempting to behave in the context of the Kashagan-BTC project similarly to the way Georgia is accused of having behaved during the BTC project itself -- using its status as a transit country to extract concessions from producing countries. Representatives of international energy companies in Baku agree that the main force behind the Azerbaijani side in the negotiations is Valekh Alasgarov, formerly the head of SOCAR's Foreign Investments Division, now a deputy speaker of parliament and chairman of parliament's energy committee. Alasgarov is supposedly getting his instructions directly from President Aliyev and will present proposed changes to the IGA in the near future.

VALEKH ALASGAROV ON POINT

¶4. (C) For his part, Alasgarov denies any role in the IGA negotiations and claims to know nothing about them. When asked if he has any opinions on the matter, however, he responds with detailed and emphatic ones. Alasgarov firmly rejects the term "Kashagan-BTC IGA" for the document, even informally. The IGA, he says, is about transporting any oil from Kazakhstan through any infrastructure in Azerbaijan -- not limited to Kashagan oil and not exclusive to BTC either. This is reflected in the current draft of the IGA. Alasgarov supports this, apparently wanting to preserve the option of sending Kazakhstan's oil via other routes like Baku-Supsa, Baku-Novorossiysk, or even rail. This point, however, is the only aspect of the current draft IGA that he likes.

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¶5. (C) Alasgarov points out that negotiations over this IGA have taken three years. By contrast, he says, in seventeen months the BTC project signed one IGA, three Host Government Agreements (HGAs), and the lump-sum turn-key construction agreement with BOTAS. The HGAs associated with this project must be negotiated simultaneously with the IGA, says Alasgarov, as the BTC HGAs were negotiated simultaneously with the BTC IGA. Otherwise, he says, Azerbaijan is undertaking commitments in the IGA that are not defined. For example, the IGA calls for granting "any necessary privileges to investors." What does this mean, asks Alasgarov rhetorically. We won't know, he says, until the HGA is negotiated. At an earlier meeting with Ambassador, Alasgarov argued that the IGA is essentially deciding the shape of the follow-on HGAs. If Azerbaijan agrees to vaguely-worded or unclear terms in the IGA, he said, the HGA may end up defining those terms in ways that force Azerbaijan to surrender certain rights. Then, Alasgarov continued, Azerbaijan will be unable to object, because it will have already conceded the point in principle in the IGA, which will have the status of an international treaty. For this reason, Alasgarov concluded, the IGA and HGA must be concluded simultaneously.

¶6. (C) Alasgarov points to a provision in the IGA which says that "all necessary conditions" will be granted to investors "without discrimination". Alasgarov says that investors in the new project will cite AIOC's rent-free occupation of the Sangachal terminal for the BTC project, for example, and demand similar rent-free access to ports in Azerbaijan. But this is inappropriate, Alasgarov says. Azerbaijan foregoes transit fees, rentals et cetera in BTC because Azerbaijan makes its profit from the oil itself. But now, he says, Azerbaijan is a transit country, and Azerbaijan has to be able to make money from transit costs, ports and the like, or it will make no profit at all on the project. Alasgarov also asked caustically why the Eskeine-Kurik line, which will bring the Kazakh oil to port for shipment to Azerbaijan, is outside the IGA-HGA framework. By contrast, he noted, every single

Azerbaijani element of the transportation system is within the IGA-HGA framework (NOTE: ConocoPhillips characterized the exclusion of Eskin-Kurik from the IGA-HGA framework as a key concession to get Kazakhstan on board with the project -- Ref B). Given these issues, Alasgarov says with finality, there is no chance that his energy committee and Azerbaijan's parliament will pass the IGA in its current form.

17. (C) In his earlier meeting with Ambassador, Alasgarov said he has met with SOCAR and with the GOAJ's ministerial-level commission negotiating the IGA to discuss his concerns. He said he has also offered the views of other members of parliament who have experience with oil contracts. Alasgarov said that he wants to cooperate with the negotiators up front to prevent problems later.

IS AN IGA NECESSARY?

18. (C) TOTAL executives in Baku continue to believe that the Kashagan-BTC project cannot go forward absent an IGA. Chevron's Tengiz-BTC project is of smaller scale and involves existing infrastructure (albeit with upgrades). The Kashagan-BTC project, by contrast, will require as much as USD 4 billion of investment in infrastructure. Much of this will be used for tankers and port facilities that, because of the geography of the Caspian, cannot be repossessed and relocated if the project fails. Without an IGA (and follow-on HGAs), investors will not have a comfort level sufficient to participate. Some way, therefore, has to be found to come to closure on the IGA if large-scale cross-Caspian oil transport is going to happen.

COMMENT

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19. (C) Regardless of the merits of his well-articulated arguments, Alasgarov seems determined to wield a veto over the IGA, and since informed opinion has it that he is acting for President Aliyev, that veto is likely to stick. Alasgarov, in his new capacity as an MP and one of the Deputy Speakers of Parliament, is also playing a role in giving parliament some teeth in its dealings on this very important issue. Beyond simply getting a better deal for Azerbaijan in terms of transit fees, Alasgarov is firm that HGAs must be negotiated alongside the IGA. He may feel this is the only way to keep the IGA negotiators from simply deferring every difficult issue to hypothetical later HGAs, which characterized the negotiations in May 2005 (Ref C). It is also in accordance with what has been a steadily hardening attitude of Azerbaijan towards the project since the failure of the May 2005 talks. There are some indicators that Azerbaijan may be moderating its stance slightly. Whether it does or not, it still seems that if negotiators can't come up with what Valekh Alasgarov defines as a good deal, Alasgarov -- and Azerbaijan -- seems willing to shrug and say "no deal."

HARNISH